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Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1992

DR SEYMOUR LICHT P.E.

Petitioner

vs

TEXAS COMMERCE BANK ET AL

Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF IN SUPPORT OF WRIT OF CERTIORARI

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TEXAS COMMERCE NATIONAL BANK'S RESPONSE IS NON- RESPONSIVE TO DR SEYMOUR LICHT QUESTIONS PRESENTED TO THIS COURT

Licht presented four questions (unanswered by TCNB) to this Honorable Court (see page "i" of Licht's Petition):

> 1. Where an interest bearing debenture is voluntarily exchanged for a "**Zero Coupon**" debenture plus other consideration ("**Boot**"): must the value of the "Boot" be subtracted from an exchanging debenture holder's claim in a subsequent bankruptcy proceeding?
>
> 2. Is unmatured interest on a "**Zero Coupon**" debenture allowable as a claim under 11 U.S.C. Section 502 (b)(2)?
>
> 3. Did the Fifth Circuit err in holding that the allowed bankruptcy claim of an unmatured $1,000.00 "**Zero Coupon**" bondholders is equal to the face amount of the "Zero Coupon"?
>
> 4. Can a Court of Appeals base its ruling on facts that are not contained in the record before the trial court?

In its Response Brief (Brief") Texas Commerce National Bank ("TCNB") attempts to evade the questions presented to the Court by unfairly re-formulating the issue as: (see page "i" of TCNB's Response Brief)

> "Does a **debt for debt face value exchange** in a consentual out of court restructuring create unmatured interest, in the form of original issue discount, within the meaning of the Bankruptcy Code provisions which disallows claims for unmatured interest?" (Emphasis added)

This question is unrelated to Licht's Petition and has nothing to do with the four (4) questions that Licht has brought before this Honorable Court.

TCNB can not claim that the reason that they ignored Licht's questions was because Licht's petition is poorly worded and did not present his arguments concisely. The October

22, 1992 issue of "BNA's Bankruptcy Law Reporter" reviewed Licht's petition in detail and cited the key points that Licht has presented to this Court in his Petition.

BNA concludes its review of Licht's petition with the following statement on page 1202:

> "The petitioner concludes that the Supreme Court should require that the claim of a "Zero Coupon" bondholder be reduced by an amount equal to the "*Unmatured interest*" for the period from the bankruptcy petition to the maturity date of the zero coupon bond and should be further reduced by the present value of the "Boot" received at the time of the exchange."

TCNB did not address these issues presumably it could not provide this Honorable Court with any rational argument in opposition to Licht's position that would also be consistent with the Fifth Circuit's ruling. Consequently TCNB addressed an

unrelated question. TCNB's unrelated response is similar to the situation where somebody has lost their wallet on Central Avenue and 3rd Street, but they went looking for it on Camelback Road and 5th Avenue because there is more light. TCNB could not answer Licht's questions so they presented their own unrelated question and answered it.

TCNB'S MISSTATEMENT OF FACTS IN THEIR RESPONSE BRIEF

On page 3 of TCNB's response brief TCNB states:

> "The debenture Holders who participated in this exchange waived the payment of past due interest (*Id.* at paragraph 24). Further, Pengo gained an additional benefit because the new Class A and Class B debentures were non-interest bearing, **allowing Pengo to accrue no interest expense with respect to the Class A and Class B debentures** (at paragraph 21) (Emphasis added).

Pengo used the accrual method of accounting. In accordance with the Financial Accounting Standard Board ("FASB") guidelines regarding "Zero Coupon" bonds Pengo made the following adjusting entries on their balance sheet upon consummation of the exchange offer for each $1,000.00 of the 8.5% bond exchanged for a $1,000.00 "Zero Coupon" bond (see "Licht's Objection to Claims of TCNB":

> a) Reduced its liability from $1,000.00 to $320.00 for each $1,000.00 8.5% bond exchanged;
>
> b) Eliminated $255.00 of accrued interest expense but not paid for each $1,000.00 8.5% bond exchanged;
>
> c) **Accrued** each year $90.67 of interest expense for each $1,000.00 "Zero Coupon" bond issued.

Contrary to TCNB assertion Pengo accrued the annual interest expense relating to the "Zero Coupon" bonds each year. Pengo, however, did not pay the interest. Pengo would have paid the interest $660.00

[($1,000.00) - ($340.00)] when they paid $1,000.00 on the maturity date of the "Zero Coupon" bond (see page 36 of Licht's petition).

PENGO'S EXCHANGE WAS NOT A FACE FOR FACE EXCHANGE

On page 4 of the Brief TCNB states:

> "In affirming the District Court's decision, the Fifth Circuit relied on an opinion issued by the Second Circuit Court of Appeals in *LTV Corp. v. Valley Fidelity Bank & Trust Co. (In Re Chateaugay Corp.)*, 961 F2d 378 (2nd Cir. 1992). In *Chateaugay*, the Second Circuit dealt with a fact situation in which the company exchanged new senior notes with a face value of $1,000.00 for an old debenture with a face value of $1,000.00. *Id.* at 380."

Again TCNB misrepresents fact that was known or should be known to them. The Chateaugay exchange was not a **"Face for Face"** exchange.

Chateaugay at 380:

> "In May 1986 LTV offered to exchange $1,000.00 face amount of New Notes and **15 shares of LTV common stock** for each $1,000.00 face amount of Old Debentures.

The fifteen (15) shares of LTV common stock had significant value at the time of the exchange and hence its value must be

considered when determining a subsequent bankruptcy claim.

TCNB further states on page 4 of their Brief:

> "As in *Chateaugay*, the Pengo exchange offer constituted a face value exchange meaning that rather than issuing the Class A and Class B debentures at a discount creating unmatured interest "Pengo simply substituted" new indebtedness for existing debentures, modifying terms and conditions but not reducing the principle amount of the debt. "*Pengo* at 547. (Citation omitted).(Emphasis added)

Again TCNB has misrepresented the true fact known to them. Pengo's exchange offer was clearly **NOT** a face for face exchange. Pengo exchanged a $1,000.00 "Zero Coupon" bond for a $1,255.00 ($1,000.00 principal plus $255.00 of accrued but unpaid interest) 8.5% bond.

TCNB also admits that the "**terms and conditions**" under which the "Zero Coupon" bond was issued was changed. TCNB contends that the modifications of these conditions

were insignificant. Licht's position is that without the modifications nobody would have accepted the exchange offer.

Pengo's "Exchange offering Circular" on page #1 (attached to "Licht's Objections to Claims of TCNB" and is part of the record before the Fifth circuit it states):

> "Pengo Finance N.V. ("Finance") hereby offers to holders of its **8.5% per. cent. Convertible Subordinated Guaranteed Debentures 1995** ("Old Debentures") upon the terms and conditions set forth herein and in the accompanying Letter of transmittal (which together constitute the "Exchange offer") $500 principal amount of its **Class A Non-interest Bearing Convertible Senior Subordinated Guaranteed Debentures due December 1, 1991 (Class A Debentures") and $500 principal amount of its Class B Non-interest Bearing Convertible Senior Subordinated Guaranteed Debentures due December 1, 1991 (Class B Debentures")** in exchange for each $1,000.00 principal amount of its Old Debentures. ***Accrued but unpaid interest on the tendered and accepted Old Debentures will be canceled.*** The Class A Debentures and Class B Debentures are

> collectively referred to as the "New Debentures". Old Debentures will be accepted only if tendered along with all coupons for interest payable on or subsequent to December 1, 1993."

The Fifth Circuit's ruling considered only part of Pengo's exchange offer. If Pengo only offered a $1,000.00 face amount "Zero Coupon" bond in exchange for a 8.5% subordinated convertible debenture with approximately four years of accrued but unpaid interest, not a single bondholder would accept said offer. **Pengo provided sufficient additional inducement to the 8.5% bond holders to accept the exchange offer by:**

a) Shortening the maturity date of the "Zero Coupon" bond from 1995 to 1991;

b) Making the "Zero Coupon" bond senior to the 8.5% bond;

c) Reducing the convertibility of the "Zero Coupon" bond to $1.25 per share while the conversion rate of the 8.5% bond remained

at $32.25 per share. (This resulted in $8,631,500.00 of "Zero Coupon" bonds being converted in Pengo stock)

Based on the financial value of the above described "Boot" Pengo's exchange was consummated. $13,365,000.00 in face amount of the 8.5% bonds were exchanged. Pengo issued $6,602,500.00 of Class A and $6,602,500.00 Class B (see stipulated facts 12 & 21). TCNB filed claims for $2,076,000.00 Class A and $2,236,000.00 Class B "Zero Coupon" bonds (see stipulated facts 6 & 7). Consequently $4,265,000.00 of Class A and $4,366,500.00 Class B "Zero Coupon" bonds were converted to Pengo common stock prior to the bankruptcy filing. Pengo's common stock at the time of the exchange had a high of $1.75 and a low of $0.6875 per share (see stipulated fact # 18).

The conclusion made by the Fifth Circuit that the Pengo's exchange was a "Face for Face" exchange could not be further from the truth. The above-described boot had significant financial value at the time of the exchange and hence the value of the "Boot" at the time of the exchange offer must be subtracted from the claim of a "Zero Coupon" bond holder in a subsequent bankruptcy. Even if this Court disregards the value of the "Boot" received by exchanging bondholders the Fifth Circuit decision that the exchange was a "FACE FOR FACE" exchange still fails to met muster. In exchange for a $1,000.00 "Zero Coupon" bond Pengo received a $1,000.00 8.5% bond and did not have to pay the accrued interest of $255.00 on each $1,000.00 8.5% bond that Pengo was carring on their books as a current liability. A $1,000.00 8.5% bond. plus $255.00 of accrued interest forgiveness, is not equal to a $1,000.00 "Zero Coupon" bond This conclusion violates all financial principal.

CONCLUSION

The United States Court of Appeals for the Fifth Circuit has clearly erred when it issued its opinion stating that the Pengo Exchange offer did not create an OID because it was a "FACE FOR FACE" exchange. The Fifth Circuit based this ruling on the fact that a $1,000.00 8.5% bond was exchanged for a $1,000.00 "Zero Coupon" bond. The Fifth Circuit disregarded the financial value of the "Boot' that accepting bondholders received and the forgiveness of the accrued but unpaid interest that Pengo received.

Licht prays that this Honorable Court will grant his Petitioner for Certiorari because left undisturbed, the Fifth Circuit's ruling below chills future out of court debt restructuring.

The petition also requests any and all other relief that this Honorable Court deems that he is entitled to.

Respectfully Submitted:

Dated this 9th day of November 1992:

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